

DEPARTMENT OF TRANSPORTATION**AUDITS AND INVESTIGATIONS**

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April 29, 2009

Michael Burns, General Manager
Santa Clara Valley Transportation Authority
3331 North First Street
San Jose, CA 95134-1906

Re: Fiscal Years 2007/08 and 2008/09 Indirect Cost Rate Proposals
P1590-0715

Dear Mr. Burns:

We have reviewed the Santa Clara Valley Transportation Authority's (VTA) Indirect Cost Rate Proposal (ICRP) for fiscal years 2007/08 and 2008/09 and the accompanying cognizant federal agency approval letter from the Federal Transit Administration (FTA). The VTA is proposing ICRP rates of 8.00% and 190.45% for capital projects for FY 2007/08 and 2008/09, respectively.

The Department of Transportation's Audits and Investigations (A&I) has concerns with the inclusion of total direct costs in the base allocation for the VTA ICRP for FY 2007/08 that deviates from the requirements of Appendix E, C.3.e of Title 2, Part 225 of the Code of Federal Regulations (CFR) – formerly the Office of Budget and Management (OMB) Circular A-87, which states:

"The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as pass-through funds, major subcontracts, etc.), direct salaries and wages, or another base which results in an equitable distribution ..."

To date, FTA has not provided evidence that the base was adjusted to exclude capital expenditures and other distorting items such as pass-through funds or major subcontracts.

A&I is also concerned that other methodologies used throughout the 15-step allocation process to allocate costs may not be supported and/or may not be reasonable to allocate costs equitably. These concerns were communicated to VTA under separate letter, on October 2, 2006. In addition, in February 2007, A&I requested from OMB an interpretation and opinion whether it is appropriate to include capital expenditures and major subcontracts in a distribution base, and if so, under what circumstances it would be allowed.

FTA's approval letter of the VTA ICRP, dated May 16, 2007, states that the approval is subject to resolution of the California Department of Transportation (Caltrans) Request for Interpretation and Opinion on the Use of Total Costs in a Distribution Base. To date, A&I

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has received no response from OMB. Therefore, A&I defers to FTA the approval of the FY 2007/08 ICRP and will allow VTA to bill indirect costs at a rate of 8.00% for its capital projects for FY 2007/08 subject to modification required by OMB, if any.

For FY 2008/09 VTA changed its methodology to use total direct labor as the base. This method complies with 2 CFR Part 225. As FTA is the cognizant federal agency for VTA, A&I defers to the FTA approval letter dated July 21, 2008, and will allow VTA to bill indirect costs at a rate of 190.45% applied to direct labor for its capital projects for FY 2008/09.

Please retain a copy of this letter with your indirect cost rate proposals. Copies of this letter were sent to the Department's District 4, the Department's Division of Accounting, the Federal Highway Administration, and the Federal Transit Administration. If you have any questions, please contact Amada Maenpaa, Audit Manager at (916) 323-7868 or Teresa Greisen, Audit Manager at (916) 323-7910.

Sincerely,

MARYANN CAMPBELL-SMITH
Chief, External Audits

- c: Brenda Bryant, Director, Financial Services, Federal Highway Administration
Sue Kiser, Director of Planning and ROW, Federal Highway Administration
Leslie T. Rogers, Regional Administrator, Federal Transit Administration
Jenny Tran, Associate Accounting Analyst, Local Assistance Accounting Branch,
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Sylvia Fung, Local Assistance Engineer, Planning and local Programs, District 4